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Review of international flood insurance and recovery mechanisms: Implications for New Zealand and the resilience of older people

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This Research Summary highlights the key findings from research about the current state of flood insurance in New Zealand and its implications for older citizens.

It accompanies the full research report "Review of international flood insurance and recovery mechanisms: Implications for New Zealand and the resilience of older people" which can be found at <http://resilience.goodhomes.co.nz/publications/>

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RESEARCH HIGHLIGHTS

- Flood insurance provision in NZ is currently robust and importantly there is some flexibility within the private market system and the premiums charged to maintain robustness.
- However, the future of recovery using insurance in NZ is threatened by: affordability, availability and adequacy of coverage, reduction in penetration rates and the balance between Earthquake Commission (EQC) cover and private market insurance.
- The premiums for flood insurance will likely increase substantially in some areas as flood risk and flood risk awareness by insurers increases: resulting in flood insurance becoming unaffordable or unavailable.
- Some older people may need additional assistance to make the most effective use of insurance: in the buying process to ensure adequate coverage and during the claims process to make best use of coverage and engaging contractors to undertake repair.
- Effective flood mitigation is critical to ensuring the availability and affordability of flood insurance. A more appropriate balance should be established in NZ between proactive risk reduction measures (at both individual and community scales) as well as insurance-facilitated recovery.
- A greater link between flood insurance and encouraging mitigation uptake, potentially through premium costs incentives, is needed.
- Raising flood risk awareness of residents is critical to effective mitigation. Additionally, there is much knowledge that can be gathered from communities frequently flooded, in particular older and more experienced residents, about how to best assist residents in recovery and the importance of insurance.
- Improved planning and better management of settlements along vulnerable coastal areas and waterways is needed to avoid increasing the numbers of older people exposed to flooding.

INTRODUCTION

There are many potential roles of insurance in promoting community resilience amongst older citizens including: assisting financial recovery from adverse natural events; spreading the burden between communities and over time; reducing the costs to the government of post-event recovery since the insured will receive insurance funds; and finally influencing mitigation behaviour.

This research concentrated on analysing domestic flood insurance approaches adopted in NZ, how they are functioning currently and what lessons can be learned from international examples. Conclusions focus specifically on the context of these issues for the recovery of older people.

RESEARCH PROCESS

International profiles of different insurance and compensation systems were drawn from desk-based research combined with communication with international researchers for clarification. This has been supplemented with interviews with New Zealand-based insurance professionals and those involved in the provision of retirement village accommodation.

Analysis included an examination of existing published research and legal and policy frameworks and each international recovery system study was evaluated according to three criteria:

- **Robustness:** examining the degree to which each insurance or compensation scheme effectively satisfies the general principles of insurance.
- **Efficiency:** the degree to which the loss-sharing arrangement is able to promote flood mitigation measures.
- **Equity**—the ways in which ideas of fairness and social justice are considered.

FLOOD INSURANCE PROVISION IN NZ

A dual system of flood insurance provision exists in NZ. Flood damages to land are currently included as part of the Earthquake Commission coverage (EQCover). This state-guaranteed pooling system was initially provided to enable insurance to be provided primarily for earthquakes and has since been extended to include damages from other natural perils. Key characteristics of EQCover in relation to flooding:

- Only flood damages to land are included within the EQC scheme
- EQCover funded by a premium surcharge of 15 cents per NZ\$100 on all household insurance policies: with a maximum surcharge of NZ\$180.
- Capped liability based on the average size of property and professional valuation at time of claim
- Importantly future flood risks caused by land damages to earthquakes are also covered.

Other flood damages to buildings are covered as a standard (and non-optional) peril as part of private household insurance cover. Key characteristics of this type of coverage include:

- A composite policy bundled with other perils including theft and fire.
- Structural and contents insurance are offered separately.
- Insurance is offered by a small group of private companies and reinsured on the global market
- Traditionally high penetration (c. 80%-95% of households have purchased an insurance policy).
- Premiums are offered on a sum-insured basis and there is no such thing as a 'standard' household policy and insurers will compete on conditions terms as well as price.
- Premiums based on the value of sum-insured.
- Currently premium costs are not differentiated according to flood risk; but some households in very high risk areas are not able to purchase cover.

ROBUSTNESS OF NZ FLOOD INSURANCE

- NZ insurance scores highly due to the pooling of the risk, the high penetration of insurance and thereby the high numbers of individuals to spread the risks between.
- The state-backing of the EQC adds robustness to the cover for land.
- NZ does not have a compensation scheme for natural hazards and therefore citizens are not discouraged from taking out insurance cover as they are in other countries (i.e. Italy, Austria).

On the whole NZ flood insurance is currently robust; both in terms of EQC land cover and private flood insurance. However, many elements may threaten the robustness in the future (see later sections) but importantly there is also flexibility and scope within the

system for increasing robustness (e.g. increasing premiums, limiting losses, introducing excesses).

EQUITY OF NZ FLOOD INSURANCE

- Individual responsibility for flood recovery dominates.
- Little differentiation between flood risks and therefore solidarity between policyholders.
- Fairness issues are raised with some hazards (e.g. earthquakes) included within the state-backed scheme whereas others excluded – causing potential inequalities.
- A key element here is transparency and how well the public are able to understand the systems.

EFFICIENCY OF NZ FLOOD INSURANCE

- Although there are some elements of mitigation tied to the current system, it is difficult to see any significant impact on risk reduction.
- Building codes are dominated by earthquake hazards.
- There are positive elements – the state intervention in the EQC means that the government is not as far removed from insurance as it is in many countries – but for flood which is insured primarily via the private market the ties are less clear.

There is large scope for a greater partnership between insurers, government and communities for taking action.

LESSONS FROM INTERNATIONAL EXAMPLES

In many ways the NZ situation offers many advantages and strengths over international examples: including:

- The effective pooling of risks through very high insurance penetration
- Market-enhancing intervention by the government to permit earthquake insurance – a peril which is often too difficult to insure.
- The compulsory inclusion of earthquake cover for those who purchase household cover
- The inclusion of recovery from flood damages to land.

The insurance systems have been remarkably robust following recent stresses and although there have been some difficulties (including the need for government intervention with AMI); ultimately there was only one withdrawal of a domestic insurer.

Although the NZ insurance systems have performed well during the stresses of the Canterbury earthquakes; it will take a long time for the government and the EQC Natural Disaster Fund to fully recover.

The need to assist financial recovery and a desire to avoid such large losses in the future has led to a number of recent changes and created emerging challenges for insurance:

- Significantly Increasing premiums (by c. 30% to 50%) for a range of reasons including: the recouping of losses from the Canterbury Earthquakes and other events, three-fold increase in EQC premium surcharges, increases in GST and increasing government regulation about the amount of reinsurance cover is required.
- Greater concern (and knowledge) by insurers about natural hazards and in particular flood risks.
- Adequacy about the balance in coverage between the EQCover and private insurance.

A key area where the NZ system can learn from elsewhere is the encouragement of future resilience to flood risk. Primarily the current system is too focussed on recovery with few incentives for reducing future risks. The NZ system could learn from the US whereby mitigation is central to the insurance system (albeit it has its own problems).

Alternatively, they may adapt the Belgian approach whereby receiving the full insurance pay-out is tied to particular actions and maybe used to encourage the reduction of future risks (although monitoring would need to be considered). Additionally, from a negative perspective, the lack of any risk-based pricing raises questions about the fairness of the approach. The greater linking between insurance premium costs and flood risks is inevitable and should be used positively to encourage the uptake of mitigation.

KEY EMERGING CHALLENGES TO THE FUTURE RESILIENCE OF OLDER PEOPLE THROUGH FLOOD INSURANCE

This section focuses on some of the key challenges and opportunities of flood insurance provision for the resilience of older people to flood hazards. It identifies those elements that make older citizens particularly vulnerable in the future.

MAINTAINING AFFORDABLE FLOOD INSURANCE FOR OLDER PEOPLE

The general costs of premiums (see above) and the introduction of risk-related pricing for flooding (where those at higher flood risk will pay more than those at a lower risk) both threaten the affordability of coverage. Increasing premiums will ultimately have the impact of reducing insurance penetration and underinsurance in particular for older people the large majority of whom are on low and fixed incomes. Additionally, older people are more likely to have paid off their mortgage and therefore may lack the incentive to maintain insurance coverage. As well as ensuring older people remain aware of the importance of coverage there is also the need to utilise ways in which insurance can remain affordable for them (e.g. monthly payments rather than large yearly premiums) and the mechanism through which they purchase it (e.g. ensuring that older people are not disadvantaged by the increasing use of electronic transactions for accessing cover or the best deals).

MAINTAINING FLOOD INSURANCE AVAILABILITY AND INCREASING EXPOSURE

Increased risk awareness by insurers and concern about future flood risks - particularly if flood events increase both in NZ and abroad (due to the global nature of the market) – may lead to insurers not only increasing premiums but altogether excluding some properties in very high risk areas from cover. Currently few households are excluded and it is more likely that premiums will rise in the first instance however if it were to occur older residents may be disproportionately impacted. Those on fixed incomes will be less able to self-insure and also less likely to be able to afford flood mitigation measures. Spatial planning measures are in some cases failing to prevent the development of new subdivisions and properties targeted at older people (such as retirement villages) in areas of very high flood; thereby exposing future residents to flood risk. Where such developments cannot be avoided, required mitigation should be mandatory.

THE EFFECTIVENESS OF INSURANCE AS A FINANCIAL RESILIENCE MECHANISM

There is some evidence to suggest that older people may need some assistance to ensure the effectiveness of insurance provision in two main areas: adequate

coverage and lack of insurance utilisation. The move to sum-insured is a major change for policyholders and older people may need additional assistance to ensure that they are not significantly underinsured. Older people may not claim, or claim fully, from their insurance policies for a number of reasons: they may choose not to claim as losses may be small and/or manageable; they may be afraid of potential premium increases or the impact of a claim on resale value; they may lack knowledge or ability to make a claim or assess losses, they may also struggle to engage or manage the rebuilding or repair process and finally an older person may be disadvantaged by insurers' moves to electronic communication. More information about the impact of claims on future premiums should be made available and insurers could do more to assist older people or prioritise their claims.

INCREASING INSURANCE-INCENTIVISED FLOOD MITIGATION

This is a key area for increasing the future resilience of older people to flood hazards. Currently flood mitigation is sparse in NZ and there are many significant barriers to its uptake:

- A lack of awareness of flood risk and therefore of the need to implement such measures.
- A lack of awareness and guidance about the mitigation options available.
- The cost of uptake of these mitigation measures.
- Lack of guidance about the potential benefits of these options and the damage savings.
- Lack of evidence of examples and an evidence base
- Lack of incentives – e.g. why implement these actions when insurance will cover the damages.

There needs to be a greater tie between insurance provision and flood mitigation to incentivise the adoption of mitigation action. Increasing premiums and/or the potential withdrawal of cover in high risk areas may be the start of this mitigation. However, some favoured flood mitigation options may be unsuitable for frail or less mobile older people such as house-raising, deploying flood gates or flood doors. There is therefore a need to focus on permanent measures and those which do not require activation: in particular the resilient reinstatement or repair of properties. Targeted measures should be introduced specifically for older people to assist them with understanding flooding, the risks they face and actions they can take to reduce flood risk.